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НОВОЕ НАПРАВЛЕНИЕ МОБИЛИЗАЦИИ ВНЕШНИХ ЗАИМСТВОВАНИЙ СОЦИАЛИСТИЧЕСКОЙ РЕСПУБЛИКИ ВЬЕТНАМ КАК ИСТОЧНИК ФИНАНСИРОВАНИЯ РАЗВИТИЯ

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В статье представлен обзор состояния государственного долга страны, более подробно рассмотрены внешние заимствования. Анализируя региональный опыт мобилизации внешних займов на цели развития, когда соседние страны достигли статуса страны с уровнем дохода ниже среднего, автор отмечает, что ключевая роль официальной помощи в целях развития (ОПР) в таких странах заключается не в восполнении дефицита сбережений. Вместо этого необходимо уменьшить бремя импорта основных капитальных благ и технологий в ходе индустриализации с учетом того, что потоки ОПР имеют важное значение для размера экономики и являются стабильными в рамках временного периода. Приводятся рекомендации для Вьетнама, полезные для разработки новой стратегии по внешним заимствованиям, в том числе с помощью международной помощи, чтобы уменьшить ограничения платежного баланса; использования ОПР для финансирования проектов по развитию; направления потоков ОПР в жизнеспособные проекты, чтобы повысить в стране производственный потенциал, и создания транспарентной, последовательной и предсказуемой системы отбора проектов.

Ключвые слова: внешние заимствования, государственный долг, страны с низким/средним уровнем дохода.

NEW DIRECTION FOR EXTERNAL BORROWING MOBILIZATION AS A DEVELOPMENT FINANCING SOURCE OF THE SOCIALIST REPUBLIC OF VIETNAM

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The paper firstly provides an overview of the country's public debt status before looking in more detail on its external borrowings. By reviewing the regional experiences in mobilizing external loans for their development when these neighboring countries reached the LMIC status, the paper argues the key role of Official Development Assistance (ODA) in such

countries not as filling the savings gap. Instead, it is to reduce the burden of importing essential capital good and technology during industrialization, given that ODA flows are significant to the size of the economy and consistent over time. The paper concludes with key lessons and recommendations for Vietnam in formulating its new strategy on external borrowings, including using overseas aid to relax the balance of payment constraint; using ODA to finance growth-enhancing projects; directing ODA flows to viable projects to enhance the country's productive capacity; and developing transparent, consistent and predictable project selection system.

Key words: external borrowing, public debt, low middle-income country.

Current Public Debt Situation in Vietnam

Since the 2008–2009 global financial crisis, Vietnam has recorded larger than normal fiscal deficits and a rapid accumulation of public debt (Figure 1¹). The government increased spending as the global crisis unfolded to substitute for export demand and prevent a sharp downturn in economic activity. After a brief period of consolidation, deficits resumed their upward trajectory in 2012, driven the combined effects of revenue shortfalls and a rise in routine expenditures. From revenue side, tariff reductions in compliance with free trade agreements, lower corporate tax rates, value added tax exemptions and a fall in global oil prices since 2013 suppressed domestic revenue growth, while on the expenditure side government salaries, social security obligations and interest payments on government debt more than offset a slowdown in public investment. Although the level of interest payments on public debt have risen in recent years they are not out of line with other countries in the region (Figure 2²).

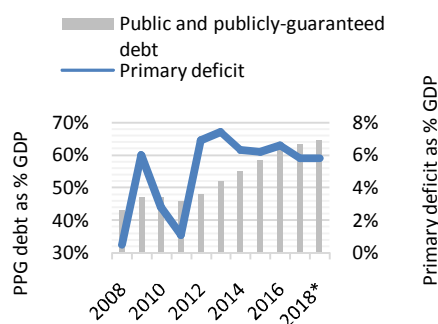


Figure 1. Public and Publicly Guaranteed Debts, and Primary Deficit in 2008-2018: 2017 and 2018 Figures are Estimated

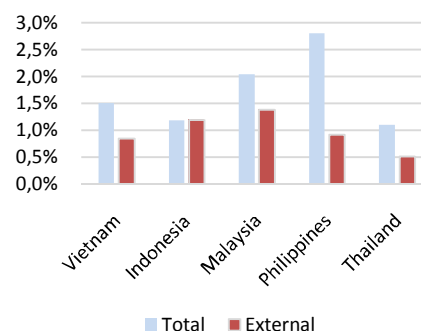


Figure 2. Interest Expenses on Total Public and External Debts as a Percentage of GDP of Selected Countries in the Region, in 2015

¹ Source: IMF.

² Source: World Bank.

Interest payments on public and publicly guaranteed external debt were equal to just 0,5% of exports in 2016. As a country that has only recently acquired low middle-income country (LMIC) status, a large share of Vietnam's external debt (40%) was acquired at concessional rates. In standard debt sustainability analysis, the stock of debt is self-stabilizing if the real interest rate-growth rate differential is negative. Given Vietnam's growth record and low average real interest rates on foreign and domestic debt, the government will have no trouble servicing the existing stock of debt out of rising government revenue absent a major economic shock. Therefore, the main challenge is containing future deficits and financing them at low cost and at acceptable levels of risk.

Nevertheless, the sharp increase in the stock of government debt over the past five years has given rise to concerns about the economic risks associated with excessive borrowing. Vietnam's graduation to LMIC status has reduced access to concessional loans, which will likely drive up average interest rates on public debt over the medium term¹. Large stocks of external debt leave the government open to exchange rate risk in the event of a sharp downturn in international trade or freezing of credit markets such as that experienced in 2008–2009. The government's increasing reliance on the domestic bond market exposes the government to increased interest rate risk, and the shorter maturities of these instruments results in higher financing costs. The fact that 70% of domestic bonds are acquired by local banks imposes some additional risks on the financial system, as any sudden fall in the value of government bonds would have immediate, negative consequences for the banks' balance sheets. Implicit guarantees on debt acquired by state-owned enterprises and local authorities are another important source of risk to debt sustainability.

In response to these concerns, the National Assembly introduced a series of thresholds for public debt and budgetary management for 2016–2020 period, aiming at strengthening the fiscal discipline [5]. It also urged the Government to develop new strategy for domestic and external borrowing to better mobilization and utilization of those funding sources for economic development of the country after graduating from low-income country (LIC) status. This paper aims to provide recommendations on mobilization of external loans for the new strategy.

External borrowings in conjunction with other development financing sources

As a result of strong growth in gross national income, Vietnam graduated from LIC status in 2008, moving to LMIC status. GNI per capita has increased robustly, more than tripling from \$680 in 2005 to \$2,060 in 2016. However, Viet Nam still lags significantly behind the ASEAN average,

¹ For example, Vietnam has graduated from the WB's ODA loans since July 01, 2017 and will graduate from the Asian Development Bank's ODA on January 1, 2016.

which reached \$8,296 per capita in 2016. Since 2010, total development investment of the countries fell to 32,8% GDP but was still 1.8 times higher than that level of 2006–2010 period. Relative to other ASEAN countries, Vietnam's total development financing was among highest both in terms of growth rate and the share in GDP (Figure 3¹). In particular, the state budget investment expenditure, though tending to slow down since Vietnam has become a LMIC, remained at 22% of total development investment and 7,2% of GDP for the entire 2010–2016 period.

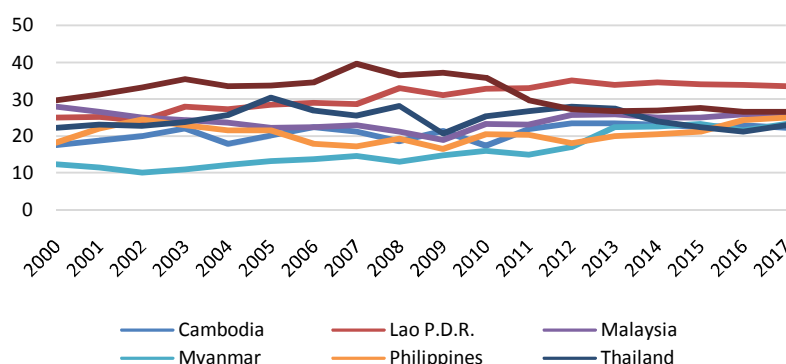


Figure 3. Total Investment to GDP Ratio in ASEAN Countries

To meet the huge financing needs for development, the government had to rely heavily on domestic and external borrowings. Domestic borrowing was mainly undertaken in the form of government bond, whose share in total government borrowing has been increased from more than 50% in 2011 to more than three fourth in the last two years. External borrowing was mainly ODA and concessional loans, whose share has been gradually fallen from almost 50% of total borrowings in 2011 to less than a quarter in 2016–2017. Total external debt stock reached USD 45,8 billion, or about 20.5% of GDP [3].

External loans mainly provided by major donors including the World Bank (WB), accounting for 29% of total external debt; Asian Development Bank (ADB) 20%; Japan 34%; China 4%; Korea 4% and France 3%. The composition of the external debt has also changed with increasing replacement of more expensive loans to ODA grant and concessional loans as Vietnam has become MIC since 2009². The acceleration of borrowing cost

¹ Source: IMF, World Economic Outlook Database.

² The percentage of external grant decreased from 20% (1993–2000) to 19% (2001–2005), 7% (2006–2010) and 4% (2011–2015). The WB credit had 40-year maturity, 10-year grace period, zero-interest and 0.75% per annum fee previously, and now 25-year maturity, 5-year grace period, 2% per annum interest rate and fee. The tenure and grace period of ADB loans also decline from 32 years and 7 years to 20 years and 5 years, respectively, with an interest rate of 2% per annum.

and foreign debt service liability has placed an increasing fiscal burden on the Government. Adding interest rate to front-end fee, the average interest rate of ODA and concessional loans now is equal to or even higher than the international market interest rate. The shift in the structure of external borrowings towards more expensive credits implies that the country needs to have new strategy for mobilizing external loans in medium to long term.

International experiences on external loan mobilization

ODA fund is one of the important sources of funds to provide additional finance to the governments in the process of economic development. LICs and LMICs tend to rely on loans or grants with terms of 25–40 years and committed low interest rates, focus on the construction of economic infrastructure when domestic conditions cannot meet their demands. ODA may generate significant economic changes in poor countries. The development of infrastructure helps foster economic growth. ODA-funded technical assistance projects may help transfer technology to beneficiary countries, develop and enhance the human resource quality. ODA supports countries to build a better investment climate, improve institutions, and increase the ability to attract foreign direct investment.

A fundamental issue in reviewing the international experiences is avoidance of a misconception assuming that developing countries do not have sufficient domestic savings to finance public investment, and that the main function of ODA is to fill this «savings gap». By contrast, as shown in many researches, capital is not the binding constraint in most LMICs¹. The main bottleneck faced by developing countries is access to timely and sufficient supplies of foreign exchange needed to acquire essential imports of capital goods and technology during the industrialization process. Those transactions are made via balance of payment instead of state budget system². Therefore, the larger the investment inflows is, the higher the demand for imports or capital and intermediate goods, and the wider the trade deficit is. This was the case in Vietnam in 2007–2008, when large inflows of FDI and portfolio capital drove widening trade and current account deficits, resulting to stronger capital inflows in capital account. In this case, if it is delivered in sufficient volumes and in a timely manner, ODA can reduce the burden of importing essential capital goods and technology during the process of industrialization, at least in medium term. The advantage over other sources of capital flows is that ODA funds are typically long-term loans at below-market interest rates, which can help

¹ This is not the case in least developed and conflict-affected countries, which generally lack access to international capital markets and where domestic financial markets are not well-developed.

² The balance of payments consists of the current and financial accounts, which, by definition, must sum to zero less errors and omissions. That is, when imports are greater than exports, the difference is financed by some combination of new debt, foreign direct investment, other investment and income flows (such as remittance).

reduce net outflows of primary income and volatility in the volume of capital inflows. Of course, to make a difference to a country's balance of payments, ODA flows must be significant relative to the size of the economy and consistent over time. However, replacing debt with more sustainable sources of foreign exchange should be a primary objective of the aid program to reduce the risk of falling into a debt trap. Among the large Asian countries, five have received aid in significant volumes and over an extended period of time (Figure 4¹): Korea, Pakistan, Bangladesh, Indonesia and Vietnam. Other countries have enjoyed brief periods of significant ODA inflows, but these have not been large enough or delivered over a sufficiently long period of time to make much of a difference in terms of access to foreign exchange.

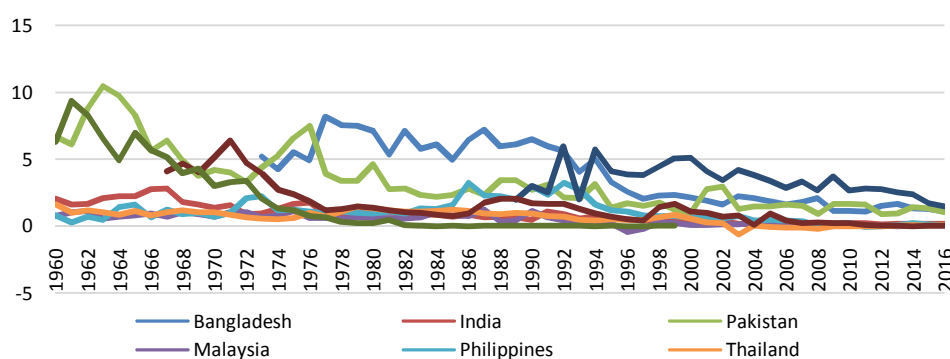


Figure 4. ODA Flows as Share of GDP, East and Southeast Asia 1960–2016

A close look at the experience of the East and Southeast Asia countries helps to emphasize the following key lessons about the role of ODA.

Firstly, the main use of overseas aid is to relax the balance of payments constraint during the early phases of industrialization. The balance of payments constraint is the key bottleneck faced by developing countries during the industrialization process, and one that surfaces with particular urgency during cyclical downturns. ODA can provide long-term loans to finance necessary imports of capital goods and technology. While recognizing that external borrowing is not a substitute for exports, the judicious use of ODA can help reduce pressure on the balance of payments over the short to medium term as domestic productive capacity develops. The stability of aid flows is an important determinant of their utility in providing developing countries access to the financing of foreign exchange requirements for its capital investment. A MIC *should refrain from using ODA to finance to finance local expenditures*, as it adds to the stock of external debt without, in most cases, increasing the country's ability to service these debts.

¹ Source: World Bank.

Secondly, aid should be focused on *growth-enhancing* capital projects – preferably investments that contribute to the country's capacity to earn foreign exchange over the medium to long term. Infrastructure (roads, rail, ports, power supply) provide essentially inputs into the growth process, as do investment in the agricultural sector (irrigation and drainage, agricultural research, rural electrification).

Thirdly, the impact of ODA is reduced by fragmentation and politicization of aid allocation. ODA can make a significant contribution to national productive capacity if it is concentrated on viable projects that transform the country's productive capacity. Consistent and concentrated coordination of a development planning agency, and a transparent, rigid and independent system of project evaluation are essential for effective use of foreign aids.

Finally, to have a neutral and transparent system of project evaluation and rankings, it is crucial to develop a set of objective evaluation and ranking indicators, which can be used consistently over project management cycle. This is also a basis for provide direction and recommendations for ODA mobilization and utilization in the next 5 years.

New direction for mobilization of external loans for Vietnam

Economic development is a gradual process. Becoming a MIC is a remarkable milestone along the way of development. However, it does not mark a sudden shift in a nation's economic capacity or the quality of life of its citizens. Without a sound development strategy, a country is more likely to fall back to a «middle income trap» when the symbolic event of graduation to middle-income status can inadvertently result in an abrupt loss of access to concessionary loans because multilateral and bilateral donors use similar indicators and smaller donors follow the lead of the large multilaterals. As a result, countries may lose access to concessional loans from all sources within a short space of time. Donors refer to this sudden loss of access as the «cliff edge». Combined with the need to service existing debt, the cliff edge can result in sudden and unexpected pressure on the balance of payments.

Vietnam will face similar choices over the next ten to fifteen years as debt service payments exceed new borrowing. Both donors and the government should work together to help Vietnam avoid a cliff edge situation and pressure on the balance of payments. To do that, Vietnam needs a sound strategic direction for ODA mobilization and utilization.

From the mobilization perspective, it is important to maintain the ODA inflow in a sufficiently large scale to make significant change in the country's development capacity, but the government should be proactive in negotiating as much as possible concessionality in external loans.

From the utilization perspective, ODA should be selectively targeted to some crucial sectors and activities where the aids are in the best use. The

government should be ready for drafting a plan in advance to phase in new lending and prepare for debt service payment on the existing stock of debt. The government's aim should be to avoid a sudden and negative impact on the balance of payment. To do that, the government should maintain a balance between domestic and external borrowings, in which new ODA loans are only use to finance the importation of technology and capital equipment.

Selection of prioritized sectors and activities for ODA loans should pursue a consistent objective as to add to the nation's growth-enhancing stock of public assets [4]. In other word, selected projects should have high benefit-cost ratio and high economic rates of return. Beyond these summative indicators (derived from feasibility studies), the government may consider additional criteria, such as the removal of critical bottlenecks; spillover effects; «crowding in» effects [6]; and the probability of success, affordability and sustainability.

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